APPENDIX A

INTERNAL REVENUE CODE OF 1939, as amended:

SEC. 23. DEDUCTIONS FROM GROSS INCOME. In computing net income there shall be allowed as deductions:

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(m) DEPLETION.—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. * * *

[ch. 1, 53 Stat. 14]

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SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION:

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(b) Basis for depletion.—

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(4) PERCENTAGE DEPLETION FOR COAL AND METAL MINES AND FOR CERTAIN OTHER MINES AND NATUEAL DEPOSITS.—

(A) In General.—The allowance for depletion under section 23(m) in the case of the following mines and other natural deposits shall be—

(i) in the case of sand, gravel, slate, stone (including pumice and scoria), brick and tile clay, shale, oyster shell, clam shell, granite, marble, sodium chloride, and, if from brine wells, calcium chloride, magnesium chloride, and bromine, 5 per centum,

(ii) in the case of coal, asbestos, brucite, dolomite, magnesite, perlite, wollastonite, calcium carbonates, and magnesium carbonates, 10 per centum,

(iii) in the case of metal mines, aplite, bauxite, fluorspar, flake graphite, vermiculite, beryl, garnet,

feldspar, mica, talc (including pyrophyllite), lepidolite, spodumene, barite, ball clay, sagger clay, china clay, phosphate rock, rock asphalt, trona, bentonite, gilsonite, thenardite, borax, fuller's earth, tripili, refractory and fire clay, quartzite, diatomaceous earth, metallurgical grade limestone, chemical grade limestone, and potash, 15 per centum, and /

(iv) in the case of sulfur, 23 per centum,

of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect to the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance under section 23(m) be less than it would be if computed without reference to this paragraph.

(B) DEFINITION OF GROSS INCOME FROM PROPERTY.—As used in this paragraph the term "gross income from the property" means the gross income from mining. The term "mining", as used herein, shall be considered to include not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products, and so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plants or mills in which the ordinary treatment processes are applied thereto as is not in excess of 50 miles unless the Secretary finds that the physical and other requirements are such that the ore or mineral must be transported a greater distance to such plants or mills. The term "ordinary treatment processes", as used herein, shall include the following: (i) In the case of coal—cleaning, breaking, sizing, and loading for shipment; (ii) in the case of sulfur—pumping to vats, cooling, breaking, and loading for shipment; (iii) in the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and minerals which are cus-

tomarily sold in the form of a crude mineral product—sorting, concentrating, and sintering to bring to shipping grade and form, and loading for shipment; and (iv) in the case of lead, zinc, copper, gold, silver, or fluorspar ores, potash, and ores which are not customarily sold in the form of the crude mineral product—crushing, grinding, and beneficiation by concentration (gravity, flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, crystallization, precipitation (but not including as an ordinary treatment process electrolytic deposition, roasting, thermal or electric smelting, or refining), or by substantially equivalent processes or combination of processes used in the separation or extraction of the product or products from the ore, including the furnacing of quicksilver ores. The principles of this subparagraph shall also be applicable in determining gross income attributable to mining for the purposes of sections 450 and 453.

[ch. 1, 53 Stat. 45; as amended by § 145(a) of Revenue Act of 1942, ch. 619, 56 Stat. 798, 840; § 124 of Revenue Act of 1943, ch. 63, 58 Stat. 21, 44; Act of August 8, 1947, ch. 515, 61 Stat. 917, 919; § 207 of Revenue Act of 1950, ch. 994, 64 Stat. 906, 931; § 304(d) of Excess Profits Tax Act of 1950, ch. 1199, 64 Stat. 1137, 1220; and § 319 of Revenue Act of 1951, ch. 521, 65 Stat. 452, 497]

INTERNAL REVENUE CODE OF 1954:

SEC. 613. (a) GENERAL RULE.—In the case of the mines, wells, and other natural deposits listed in subsection (b), the allowance for depletion under section 611 shall be the percentage, specified in subsection (b), of the gross income from the property excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 percent of the taxpayer's taxable income from the property (computed without allowance for depletion). In no case shall the allowance for depletion under section 611 be less than it would be if computed without reference to this section.

(b) PERCENTAGE DEPLETION RATES.—The mines, wells, and other natural deposits, and the percentages, referred to in subsection (a) are as follows:

(1) 27½ percent—oil and gas wells.

(2) 23 percent—

(A) sulfur and uranium; and

(B) if from deposits in the United States—anorthosite (to the extent that alumina and aluminum compounds are extracted therefrom), asbestos, bauxite, beryl, celestite, chromite, corundum, fluorspar, graphite, ilmenite, kyanite, mica, olivine, quartz crystals (radio grade), rutile, block steatite tale, and zircon, and ores of the following metals: antimony, bismuth, cadmium, cobalt, columbium, lead, lithium, manganese, mercury, nickel, platinum and platinum group metals, tantalum, thorium, tin, titanium, tungsten, vanadium, and zinc.

(3) 15 percent—ball clay, bentonite, china clay, sagger clay, metal mines (if paragraph (2)(B) does not apply), rock asphalt, and vermiculite.

(4) 10 percent—asbestos (if paragraph (2)(B) does not apply), brucite, coal, lignite, perlite, sodium chloride, and wollastonite.

(5) 5 percent—

(A) brick and tile clay, gravel, mollusk shells (including clam shells and oyster shells), peat, pumice, sand, scoria, shale, and stone, except stone described in paragraph (6); and

(B) if from brine wells—bromine, calcium chloride, and magnesium chloride.

(6) 15 percent—all other minerals (including, but not limited to, aplite, barite, borax, calcium carbonates, refractory and fire clay, diatomaceous earth, dolomite, feldspar, fullers earth, garnet, gilsonite, granite, limestone, magnesite, magnesium carbonates, marble, phosphate rock, potash, quartzite, slate, soapstone, stone (used or sold for use by the mine owner or oper-

ator as dimension stone or ornamental stone), thenardite, tripoli, trona, and (if paragraph (2)(B) does not apply) bauxite, beryl, flake graphite, fluorspar, lepidolite, mica, spodumene, and talc, including pyrophyllite), except that, unless sold on bid in direct competition with a bona fide bid to sell a mineral listed in paragraph (3), the percentage shall be 5 percent for any such other mineral when used, or sold for use, by the mine owner or operator as rip rap, ballast, road material, rubble, concrete aggregates, or for similar purposes. For purposes of this paragraph, the term "all other minerals" does not include—

(A) soil, sod, dirt, turf, water, or mosses; or

(B) minerals from sea water, the air, or similar inexhaustible sources.

(c) DEFINITION OF GROSS INCOME FROM PROPERTY.—For purposes of this section—

(1) GROSS INCOME FROM THE PROPERTY.—The term "gross income from the property" means, in the case of a property other than an oil or gas well, the gross income from mining.

(2) MINING.—The term "mining" includes not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products, and so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plants or mills in which the ordinary treatment processes are applied thereto as is not in excess of 50 miles unless the Secretary or his delegate finds that the physical and other requirements are such that the ore or mineral must be transported a greater distance to such plants or mills.

(3) EXTRACTION OF THE ORES OR MINERALS FROM THE GROUND.—The term "extraction of the ores or minerals from the ground" includes the extraction by mine owners or operators of ores or minerals from the

waste or residue of prior mining. The preceding sentence shall not apply to any such extraction of the mineral or ore by a purchaser of such waste or residue or of the rights to extract ores or minerals therefrom.

(4) ORDINARY TREATMENT PROCESSES.—The term "ordinary treatment processes" includes the following:

(A) In the case of coal—cleaning, breaking, sizing, dust allaying, treating to prevent freezing, and loading for shipment;

(B) in the case of sulfur recovered by the Frasch process—pumping to vats, cooling, breaking, and loading for shipment;

(C) in the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and minerals which are customarily sold in the form of a crude mineral product—sorting, concentrating, and sintering to bring to shipping grade and form, and loading for shipment;

(D) in the case of lead, zinc, copper, gold, silver, or fluorspar ores, potash, and ores which are not customarily sold in the form of the crude mineral product—crushing, grinding, and beneficiation by concentration (gravity, flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, crystallization, precipitation (but not including as an ordinary treatment process electrolytic deposition, roasting, thermal or electric smelting, or refining), or by substantially equivalent processes or combination of processes used in the separation or extraction of the product or products from the ore, including the furnacing of quicksilver ores; and

(E) the pulverization of talc, the burning of magnesite, and the sintering and nodulizing of phosphate rock.

[ch. 736, 68A Stat. 208; subsequently amended, effective for later taxable years by § 36 of Technical Amendments Act of 1958; 72 Stat. 1606, 1633, by § 302 of Tax Rate Extension Act of 1960, 74 Stat. 290, 291, and by § 13(c) of Revenue Act of 1962, 76 Stat. 960, 1034]

TREASURY REGULATIONS 111, PROMULGATED UNDER THE INTERNAL REVENUE CODE OF 1939:

SEC. 29.23(m)-1. DEPLETION OF MINES, OIL AND GAS WELLS, OTHER NATURAL DEPOSITS, AND TIMBER; DEPRECIATION OF IMPROVEMENTS.—Section 23 (m) provides that there shall be allowed as a deduction in computing net income in the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements. Section 114 prescribes the bases upon which depreciation and depletion are to be allowed.

Under such provisions, the owner of an economic interest in mineral deposits or standing timber is allowed annual depletion deductions. However, no depletion deduction shall be allowed with respect to any timber or coal which such owner has disposed of under any form of contract by virtue of which he retains an economic interest in such timber or coal, if such disposal is considered a sale of timber or coal under section 117 (k) (2) of the Code. An economic interest is possessed in every case in which the taxpayer has acquired, by investment, any interest in mineral in place or standing timber and secures, by any form of legal relationship, income derived from the severance and sale of the mineral or timber, to which he must look for a return of his capital. But a person who has no capital investment in the mineral deposit or standing timber does not possess an economic interest merely because, through a contractual relation to the owner, he possesses a mere economic advantage derived from production. Thus, an agreement between the owner of an economic interest and another entitling the latter to purchase the product upon production or to share in the net income derived from the interest of such owner does not convey a depletable economic interest.

The adjusted basis of depreciable property is returnable through annual depreciation deductions. Depreciation and

depletion deductions on the property of a corporation are allowed to the corporation and not to its shareholders. (But see section 29.115-6.) The principles governing the apportionment of depreciation in the case of property held by one person for life with remainder to another person and in the case of property held in trust are also applicable to depletion. (See section 29.23(l)-1.)

When used in these sections (29.23(m)-1 to 29.23(m)-28, inclusive) covering depletion and depreciation—

(*a*) The "fair market value" of a property is that amount which would induce a willing seller to sell and a willing buyer to purchase.

(*b*) A "mineral property" is the mineral deposit, the development and plant necessary for its extraction, and so much of the surface of the land only as is necessary for purposes of mineral extraction. The value of a mineral property is the combined value of its component parts.

(*c*) The term "mineral deposit" refers to minerals in place. The cost of a mineral deposit is that proportion of the total cost of the mineral property which the value of the deposit bears to the value of the property at the time of its purchase.

(*d*) "Minerals" include ores of the metals, coal, oil, gas, and such nonmetallic substances as abrasives, asbestos, asphaltum, barite, beryl, borax, building stone, cement rock, clay, crushed stone, feldspar, fluorspar, fuller's earth, graphite, gravel, gypsum, lepidolite, limestone, magnesite, marl, mica, mineral pigments, peat, potash, precious stones, refractories, rock phosphate, salt, sand, silica, slate, soapstone, soda, spodumene, sulphur, talc, and vermiculite.

(*e*) The term "mine" does not include oil and gas wells.

(*f*) The term "gross income from the property", as used in sections 114 (b) (3) and 114 (b) (4)(A) and sections 29.23 (m)-1 to 29.23 (m)-19, inclusive, means the following:

In the case of oil and gas wells, "gross income from the property" as used in section 114(b) (3) means the amount for which the taxpayer sells the oil and gas in the immediate vicinity of the well. If the oil and gas are not sold on the property but are manufactured or converted into a refined product prior to sale, or are transported from the property prior to sale, the gross income from the property shall be assumed to be equivalent to the representative market or field price (as of the date of sale) of the oil and gas before conversion or transportation.

In the case of a crude mineral product other than oil and gas, "gross income from the property", as used in section 114 (b) (4)(A) means the gross income from mining. The term "mining" as used herein includes not only the extraction of ores or minerals from the ground but also the ordinary treatment processes which are normally applied by the mine owners or operators to the crude mineral product after extraction in order to obtain the commercially marketable mineral product or products. For taxable years beginning after December 31, 1949, the term "mining" as used herein also includes so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plants or mills in which the ordinary treatment processes are applied thereto as is not in excess of 50 miles, and, if the Commissioner finds that both the physical and other requirements are such that the ore or mineral must be transported a greater distance to such plants or mills, the transportation over such greater distance. The taxpayer shall file an orginal and one copy of an application for the inclu-

sion of such greater distance in the computation of his gross income from mining with the Commissioner of Internal Revenue, Washington 25, D. C., attention of the Special Technical Services Division, Engineering and Valuation Branch. The application must include a statement setting forth in detail such facts concerning the physical and other requirements for the construction and operation of a treatment plant at a place nearer to the point of extraction from the ground as are sufficient to apprise the Commissioner of the exact basis of the application. If the taxpayer's return is filed prior to receipt of notice of the Commissioner's action upon the application, a copy of such application shall be attached to the return. If, after an application is approved by the Commissioner, there is a material cange in any of the facts relied upon in such application, a new application must be submitted by the taxpayer.

If the taxpayer sells the crude mineral product of the property in the immediate vicinity of the mine, "gross income from the property" means the amount for which such product was sold, but if the product is transported or processed (other than by the ordinary treatment processes described below) before sale, "gross income from property" means the representative market or field price (as of the date of sale) of a mineral product of like kind and grade as beneficiated by the ordinary treatment processes actually applied, before transportation of such product (other than transportation treated, for the taxable year, as mining). If there is no such representative market or field price (as of the date of sale) then there shall be used in lieu thereof the representative market or field price of the first marketable product resulting from any process or processes (or, if the product in its crude mineral state is merely transported, the price for which sold) minus the costs and proportionate profits attributable to the trans-

portation (other than transportation treated, for the taxable year, as mining) and the processes beyond the ordinary treatment processes. If the taxpayer establishes to the satisfaction of the Commissioner that another method of computation, other than the computation of profits proportionate to costs, clearly reflects the gross income from the property, then such gross income shall be computed by the use of such other method. For a description of transportation which is treated, for taxable years beginning after December 31, 1949, as mining, see the preceding paragraph and section 114 (b)(4)(B), as amended. (Italics supplied)

The term "ordinary treatment processes", as used herein, shall include the following:

(1) In the case of coal—cleaning, breaking, sizing and loading for shipment;,

(2) In the case of sulphur—pumping to vats, cooling, breaking, and loading for shipment;

(3) In the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and minerals which are customarily sold in the form of a crude mineral product—sorting, concentrating, and sintering (agglomerating by incipient fusion) to bring to shipping grade and form, and loading for shipment;

(4) In the case of lead, zinc, copper, gold, silver or fluorspar ores, potash, and minerals which are not customarily sold in the form of the crude mineral product—crushing, grinding, and beneficiation by concentration (gravity, flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, crystallization, precipitation, or by substantially equivalent processes or combination of processes used in the separation or extraction of the product or products from the mineral. The furnacing of quicksilver ores is included in the

term "ordinary treatment processes". The following processes are not included in the term "ordinary treatment processes": electrolytic deposition, roasting, thermal or electric smelting, refining, or substantially equivalent processes.

In addition, the processes listed below are not included in the term "ordinary treatment processes" unless such processes are (i) otherwise provided for in (1), (2), (3) or (4) above; (ii) necessary or incidental to the processes provided for in (1), (2), (3) or (4) above; or (iii) necessary to bring the ores or minerals into condition or form suitable for shipment (for example, the agglomeration of concentrates):

(A) treatment effecting a chemical change,

(B) blending with other material,

(C) thermal action,

(D) fine pulverization; pressing into shape or molding.

For the purposes of (3) and (4) above, the terms "concentration" or "concentrating" mean the process of eliminating waste or of separating two or more minerals or ores.

For taxable years beginning before January 1, 1950, in case any of the ordinary treatment processes are not applied in the immediate vicinity of the mining district in which the mine is located, costs incurred for transportation to the processing location and, if transported by the taxpayer, the proportionate profits attributable to transportation, should be subtracted from the sale price of the product to determine "gross income from the property." For taxable years beginning after December 31, 1949, in determining "gross income from the property", the sale price of the product shall not be reduced by the costs and pro-

portionate profits attributable to the transportation which is treated for such taxable year as mining, that is, so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plants or mills in which the ordinary treatment processes are applied thereto as is not in excess of 50 miles (or, if the Commissioner finds that both the physical and other requirements are such that the ore or mineral must be transported a greater distance to such plants or mills, such greater distance). Where such plants or mills are in excess of 50 miles (or of such greater distance) from the point of extraction from the ground, then costs incurred for transportation in excess of 50 miles (or of such greater distance) to the treatment plant and, if transported by the taxpayer, the proportionate profits attributable to such excess transportation should be subtracted from the sale price of the product to determine "gross income from the property." In the absence of methods which will clearly reflect costs of the various phases of transportation, the costs attributable to such excess transportation shall be an amount which is in the same ratio to the costs incurred for the total transportation to the treatment plant as the excess transportation is to such total transportation. If the taxpayer establishes to the satisfaction of the Commissioner that another method of computation, other than the computation of profits proportionate to costs, clearly reflects the gross income from the property, then such gross income shall be computed by the use of such other method.

In all cases there shall be excluded in determining the "gross income from the property" an amount equal to any rents or royalties which were paid or incurred by the taxpayer in respect to the property and are not otherwise excluded from the "gross income from the property." If

royalties in the form of bonus payments have been paid in respect of the property in the taxable year or any prior years, or if advanced royalties have been paid in respect of the property in any taxable year ending prior to December 31, 1939, the amount excluded from "gross income from the property" for the current taxable year on account of such payments shall be an amount equal to that part of such payments which is allocable to the product sold during the current taxable year. If advanced royalties have been paid in respect of the property in any taxable year ending on or after December 31, 1939, the amount excluded from "gross income from the property" for the current taxable year on account of such payments shall be an amount equal to the deduction for such taxable year taken on account of such payments pursuant to section 29.23(m)-10(*e*).

Rents and royalties paid or incurred by a taxpayer with respect to coal shall be excluded from the "gross income from the property" without regard to the treatment under section 117 (k) (2) of such rents and royalties in the hands of the recipient.

(*g*) "Net income of the taxpayer (computed without allowance for depletion) from the property," as used in section 114 (b) (2), (3), and (4) and sections 29.23(m)-1 to 29.23(m)-19, inclusive, means the "gross income from the property" as defined in paragraph (*f*) of this section less the allowable deductions attributable to the mineral property upon which the depletion is claimed and the allowable deductions attributable to the processes listed in paragraph (*f*) in so far as they relate to the product of such property, including overhead and operating expenses, development costs properly charged to expense or allowable as deductions under section 23 (*cc*), depreciation, taxes, losses sustained, etc., but excluding any allowance for depletion. Deductions not directly attributable to particular properties or processes shall be fairly allocated. To illustrate: In cases where the taxpayer engages in activities in addition to mineral extraction and to the processes listed in para-

graph (*f*), deductions for depreciation, taxes, general expenses, and overhead, which cannot be directly attributed to any specific activity, shall be fairly apportioned between (1) the mineral extraction and the processes listed in paragraph (*f*) and (2) the additional activities, taking into account the ratio which the operating expenses directly attributable to the mineral extraction, and the processes listed in paragraph (*f*) bear to the operating expenses directly attributable to the additional activities. If more than one mineral property is involved, the deductions apportioned to the mineral extraction and the processes listed in paragraph (*f*) shall, in turn, be fairly apportioned to the several properties, taking into account their relative production.

(*h*) "Crude mineral product," as used in paragraph (*f*) of this section, means the product in the form in which it emerges from the mine or well.

(*i*) "The property," as used in section 114(b) (2), (3), and (4) and section 29.23(m)-1 to 29.23(m)-19, inclusive, means the interest owned by the taxpayer in any mineral property. The taxpayer's interest in each separate mineral property is a separate "property"; but, where two or more mineral properties are included in a single tract or parcel of land, the taxpayer's interest in such mineral properties may be considered to be a single "property," provided such treatment is consistently followed.

[as amended by T.D. 5413, 1944 Cum. Bull. 124; T.D. 5458, 1945 Cum. Bull. 45; T.D. 5461, 1945 Cum. Bull. 284; T.D. 6004, 1953-1 Cum. Bull. 45; T.D. 6021, 1953-2 Cum. Bull. 169; T.D. 6023, 1953-2 Cum. Bull. 132; T.D. 6031, 1953-2 Cum. Bull. 120]

TREASURY REGULATIONS 118, PROMULGATED UNDER THE INTERNAL REVENUE CODE OF 1939 FOR YEARS BEGINNING AFTER DECEMBER 31, 1951:

[Sec. 39.23(m)-1, as amended by T.D. 6059, 1954-1 Cum. Bull. 80 and T.D. 6096, 1954-2 Cum. Bull. 69, was the same

as Sec. 29.23(m)-1 of Treasury Regulations 111 except for stylistic changes, revision of section number and references, and a few specific substantive changes which are not material to the instant case.]

TREASURY REGULATIONS 1.613-3 (*b*), (*c*), (*d*) AS PROPOSED ON NOVEMBER 3, 1956 (21 FED. REG. 8439) FOR PROMULGATION UNDER THE INTERNAL REVENUE CODE OF 1954 AND CONTINUED AS PROPOSED REGULATIONS UNDER T. D. 6446 (1960-1 Cum. Bull. 208):

§ 1.613-3 Gross Income from the property — (a) • • •

• • • •

(b) *Gross income from mining.* (1) The term "gross income from the property", as used in section 613(c)(1), means, in the case of a property (other than an oil or gas property), gross income from mining. For the purposes of this paragraph, transportation which qualifies as "mining" will be referred to as "mining transportation" and transportation which does not qualify as "mining" will be referred to as "non-mining transportation". (See § 1.613-3 (c)(7) for definition of the term "mining".)

(2) "Gross income from mining" is the portion of the taxpayer's gross income which is attributable to the extraction of the minerals from the mine, the application to the crude mineral product (see § 1.613-3(c)(1)) of ordinary treatment processes (see § 1.613-3(d)) and mining transportation.

(3) Examples of the application of the rule described in subparagraph (2) follow:

(i) If a taxpayer sells

(*a*) The crude mineral product without any tranportation costs having been incurred, or

(*b*) The processed mineral product (see § 1.613-3(c)(2)) without any transportation costs having been incurred, or

(*c*) The processed mineral product as to which only mining transportation costs have been incurred,

"gross income from mining" means the amount for which such mineral product was sold.

(ii) If a taxpayer sells

(*a*) The crude mineral product as to which transportation costs have been incurred, or

(*b*) The manufactured product (see § 1.613-3(c)(3)) as to which no ordinary treatment processes were applied and no transportation costs were incurred, or

(*c*) The manufactured product as to which no ordinary treatment processes were applied and transportation costs were incurred,

"gross income from mining" means the market price (as of the date of the sale of the mineral product referred to in (*a*) and the manufactured products in (*b*) and (*c*) of this subdivision) of the untransported crude mineral product referred to in (*a*) of this subdivision, or the untransported crude mineral product used to produce the manufactured products referred to in (*b*) and (*c*) of this subdivision.

(iii) If a taxpayer sells.

(*a*) The processed mineral product as to which only non-mining transportation costs have been incurred, or

(*b*) The processed mineral product as to which both mining and non-mining transportation costs have been incurred, or

(*c*) The manufactured product as to which ordinary treatment processes have been applied and no transportation costs have been incurred, or

(*d*) The manufactured product as to which ordinary treatment processes have been applied and only mining transportation costs have been incurred, or

(*e*) The manufactured product as to which ordinary treatment processes have been applied and only non-mining transportation costs have been incurred, or

(*f*) The manufactured product as to which ordinary treatment processes have been applied and both mining and non-mining transportation costs have been incurred.

"gross income from mining" means the market price (as of the date of sale of the products referred to in (*a*) through (*f*), of this subdivision) of a processed mineral product obtained by applying to the crude mineral product the ordinary treatment processes actually applied and mining transportation costs actually incurred by the taxpayer to produce the particular mineral product described in (*a*), (*b*), (*c*), (*d*), (*e*), and (*f*) of this subdivision.

(4) The mineral product to which the market price (referred to in subdivision (ii) and (iii) of subparagraph (3)) is applied is designated, herein, as the "gross income product". For the purpose of this paragraph the term "market price" means the price (as of the date the taxpayer actually sells his crude mineral product or processed mineral product or manufactured product, as the case may be) at which the gross income product is sold commercially in the vicinity of the taxpayer's mine. However, in no case

shall the market price of the gross income product exceed the amount actually realized from the gross income product. If there are no such commercial sales in such area, then the market price of the gross income product (as of the date the taxpayer sells his crude mineral product or processed mineral product or manufactured product as the case may be) must be determined by the use of other appropriate methods with the objective of determining as accurately as practicable the price at which such gross income product would be sold if such commercial sales existed. Among such methods that may be appropriate, depending on the circumstances of each individual case, are the following:

(i) Comparison with the prices at which crude mineral products or processed mineral products similar to the taxpayer's gross income product are sold commercially in the vicinity of the taxpayer's mine with proper adjustment being made for material differences, if any, between the taxpayer's gross income product and the products sold commercially (such as differences in kind or grade or mineral content or ordinary treatment processes involved or transportation costs between mine and market or relative volume of sales).

(ii) Comparison with the prices at which crude mineral products or processed mineral products identical or similar to the taxpayer's gross income product are sold commercially in other areas, with proper adjustments being made for material differences, if any, between the taxpayer's gross income product and the products sold commercially (such as differences in kind or grade or mineral content or ordinary treatment processes involved or transportation costs between mine and market or relative volume of sales).

(iii) Computation based on the taxpayer's costs of producing the gross income product plus a rate of profit (determined to be appropriate) per unit of prod-

duct, per dollar of cost, or per dollar of investment in mining. Such rate of profit may be ascertained:

(*a*) By comparison with the rate of profit currently realized on commercial sales of identical or similar crude mineral products or processed mineral product, or

(*b*) By comparison with the rate of profit currently realized by the taxpayer on sales of his products, or

(*c*) By comparison with a rate of profit ascertained by any other appropriate method.

In utilizing comparative prices for the determination of market prices, greater weight should be given to prices (1) of commercial sales made closest in time to the sale of the mineral product by the taxpayer, (2) of mineral products most nearly similar to the gross income product of the taxpayer, and (3) of mineral products sold commercially in areas closest to the mines of the taxpayer. In utilizing the taxpayer's costs of producing the gross income product in determining its market price, only costs actually incurred shall be taken into consideration. Such costs will usually be reflected on the books and records the taxpayer maintains for cost control and other ordinary business purposes. Certain deductions allowed for tax purposes in the nature of special incentives, such as that of accelerated amortization of emergency facilities under section 168, for exploration and development expenditures under sections 615(a), and 616(a), respectively, and similar deductions, would not ordinarily be taken into consideration in determining market prices as set out above.

(5) The rule with respect to manufactured products described in subparagraph (3)(ii)(*b*), and (*c*) and (iii) (*c*), (*d*), (*e*) and (*f*) and subparagraph (4) that the market price of the gross income product must be computed as of

the date that such manufactured product is sold by the taxpayer shall not apply in cases where the taxpayer shows to the satisfaction of the Commissioner that it is impractical and unrealistic to require him to compute the market price of the gross income product as of the date he sells the end product. In such exceptional cases, the taxpayer may compute the market price as of the date he transports the gross income product from the premises of the mine to the manufacturing facilities. A taxpayer shall employ this method only so long as he can demonstrate his inability reasonably to compute the market price of his gross income product as of the date he sells the manufactured product and only to the extent that there results no distortion of the allowance for depletion. Any taxpayer employing this method must consistently compute cost depletion by using as the number of units of mineral sold, the same number of units used in the determination of the gross income product transported from the premises of the mine.

(6) To the return of a taxpayer computing gross income from mining under subparagraph (4) above, there shall be attached a statement describing the gross income product involved and the method or methods employed by the taxpayer in determining the market price of the gross income product. Such statement shall include:

(i) If comparative prices were used—

(*a*) The prices so used, and

(*b*) Any adjustments that were made because of differences between taxpayer's gross income product and the mineral product used for comparison.

(ii) If costs were used—

(*a*) The costs so used,

(*b*) The rate of profit applied,

(*c*) The method used in determining the rate of profit, and

(*d*) Any comparative rates of profits used and the reasons for their use.

(iii) If any other method or combination of methods were employed, complete details and computations involved in using these methods, and

(iv) Any additional data necessary for a complete understanding of the method or methods employed and the computations involved in determining the market price.

(c) *Definitions of terms applicable to gross income from mining.* Where used in section 613(c) and paragraphs (b) and (c) of this section, the term—

(1) "Crude mineral product" means the mineral in the form in which it emerges from the mine.

(2) "Processed mineral product" means the mineral product which is obtained by application to the crude mineral product of one or more of the ordinary treatment processes.

(3) "Manufactured product" means the product which is obtained by the application to the crude mineral product or processed mineral product of processes which are not ordinary treatment processes.

(4) "Mineral product" means the crude mineral product or processed mineral product.

(5) "Commercially marketable mineral product or products" means the mineral product or products sold by the taxpayer or used by him in his trade or business whether in the form of crude, or processed mineral product.

(6) "Mine owners or operators" refers to taxpayers who are engaged in mining as defined in subparagraph (7)

below: Where a taxpayer both engages in mining and applies to the crude mineral product or processed mineral product processes other than ordinary treatment processes, he is a "mine owner or operator" with respect to the extraction of minerals from the mine and the application to such minerals of ordinary treatment processes, but with respect to the application of other than ordinary treatment processes he is a manufacturer. Thus, the term "mine owners or operators" in the term "ordinary treatment processes normally applied by mine owners or operators" refers to the taxpayer in his capacity as an operator of a mine and not in his capacity as a manufacturer.

(7) "Mining" includes not only the extraction of ores or minerals (other than oil and gas) from the ground but also the ordinary treatment processes which are normally applied by mine owners or operators to the crude mineral product after extraction to obtain the commercially marketable mineral product or products. The term "mining" also includes so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plants or mills in which ordinary treatment processes are applied thereto as is not in excess of 50 miles, and if the Commissioner finds that both the physical and other requirements are such that the ore or mineral must be transported a greater distance to such plants or mills, the transportation over such greater distance. (See paragraph (e) of this section for filing of application to treat transportation in excess of 50 miles as mining.)

(8) "Extraction of ores or minerals from the ground" means not only the extraction of ores or minerals from a deposit, but also the extraction by mine owners or operators of ores or minerals from waste or residue of prior mining. The preceding sentence does not apply to any such extrac-

tion of ores or minerals by the purchaser of such waste or residue or the purchaser of the rights to extract ores or minerals from such waste or residue. The term "purchaser" does not apply to any person who acquires mineral property, including such waste or residue, in a tax-free exchange, such as corporate reorganization, from a person who was entitled to a depletion allowance upon ores or minerals produced from such waste or residue. The term "purchaser" also does not apply to a lessee, upon the renewal of a mineral lease without an intervening lapse, if the lessee was entitled to a depletion allowance upon ores or minerals produced from such waste or residue before renewal of the lease. It is not necessary, for purposes of the preceding sentence, that the mineral lease contain an option for renewal. The term "purchaser" does include a person who acquires such waste or residue in a taxable transaction, even though such waste or residue is acquired merely as an incidental part of the entire mineral enterprise. It is immaterial whether the waste or residue result from the process of extraction from the ground or from application of the ordinary treatment processes provided for in § 1.613-3(d). However, extraction of ores or minerals from waste or residue which results from processes which are not allowable as ordinary treatment processes is not treated as mining. For special rules with respect to certain corporate acquisitions referred to in section 381(a), see section 381(c)(18) and the regulations thereunder.

(d) *Ordinary treatment processes*—(1) *In general.* Section 613(c)(2) provides as a general rule that the term "mining" includes not merely the extraction of ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators to obtain the commercially marketable mineral product or products and certain mining transportation described in paragraph (c)(7) of this section. In amplification of this

general rule, section 613(c)(4) lists a number of specific ores and minerals and certain designated processes which, when applied to such specific ores and minerals, may be treated as mining. In addition, that section also lists two general classes of ores or minerals and a number of processes which when applied thereto will also be treated as mining. These general classes are: (i) minerals (including ores) customarily sold in the form of a crude mineral product and (ii) ores which are not customarily sold in the form of the crude mineral product. In the case of these two classes, the processes prescribed are generally descriptive of the types of processes normally applied by mine owners or operators in general as part of their mining operations for the purpose of separating the mineral or ore from waste or from other mineral or ore and to put the mineral or ore in condition suitable for shipment. Accordingly, in the case of any mineral or ore not specifically designated in section 613(c)(4) the processes which may be treated as mining will depend on its classification and the form in which it is customarily sold. If the product sold is a mineral that is customarily sold in the form of a crude mineral product, the processes described in subparagraph (2)(iii) of this paragraph may be treated as mining, and if the product sold is an ore that is not customarily sold in the form of a crude mineral product, the processes described in subparagraph (2)(iv) of this paragraph may be treated as mining. In any case, where the product sold is a mineral that is not customarily sold in the form of a crude mineral product the term "ordinary treatment processes" which may be treated as mining refers only to processes of the type which mine owners or operators, as a class, would normally or ordinarily apply as an incident of mining, as distinguished from manufacturing. In such case, the processes incident to mining are those processes applied for the purpose of separating a mineral or ore from waste or other

minerals or ores and the conditioning thereof for shipment. For example, if the taxpayer is in an industry which customarily is engaged in mining, manufacturing, and the sale of only manufactured products, such as finished clay products, the only processes applied to the crude mineral product which may be treated as mining are those described in the preceding sentence since the products sold are classified as minerals not sold in the form of a crude mineral product.

(2) *Definition of ordinary treatment processes.* Where used in section 613(c) and paragraphs (b) and (c) of this section, the term "ordinary treatment processes" means—

(i) In the case of coal—cleaning, breaking, sizing, dust allaying, treating to prevent freezing and loading for shipment;

(ii) In the case of sulfur recovered by the Frasch process—pumping to vats, cooling, breaking and loading for shipment;

(iii) In the case of iron ore, bauxite, ball and sagger clay, rock asphalt and minerals which are customarily sold in the form of the crude mineral product—sorting, concentrating (or substantially equivalent processes or combination of processes used in the separation or extraction of the mineral or minerals from the ore) and sintering to bring to shipping grade and form and loading for shipment;

(iv) In the case of lead, zinc, copper, gold, silver or fluorspar ores, potash and ores which are not customarily sold in the form of the crude mineral product—crushing, grinding and beneficiation by concentration (gravity, flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, crystallization, precipitation, or by substantially equivalent processes or combination of processes used in the separation or extraction of the mineral or minerals from the ore;

(v) In the case of minerals to which subdivision (iv) of this subparagraph is not applicable—

(*a*) Any process applied for the purpose of separating the mineral or ore from waste or from other minerals or ores, and

(*b*) Any process necessary to put the ore or mineral in condition for shipment.

(vi) In addition to the processes described in subdivisions (iii), (iv), and (v) of this subparagraph, depending upon in which subdivision the particular mineral or ore named in this subdivision is included—

(*a*) The furnacing of quicksilver,

(*b*) The pulverization of talc,

(*c*) The burning of magnesite, and

(*d*) The sintering and nodulizing of phosphate rock.

(3) *Nonmining processes.* Unless a process is covered by the provisions of subparagraph (2) (i) through (vi) of this paragraph, such process shall not be treated as an ordinary treatment process. Such nonmining processes include electrolytic deposition, roasting, thermal or electric smelting, and refining. In addition, any process effecting a chemical change, the blending with other material, a thermal action including drying, and fine pulverization, pressing into shape or molding, is not included in the term "ordinary treatment processes" unless such process is:

(i) Otherwise provided for in subdivisions (i) through (vi) of subparagraph (2) of this paragraph; or

(ii) Necessary or incidental to the processes provided for in subdivisions (i) through (vi) of subparagraph (2) of this paragraph; or

(iii) Necessary to bring the ores or minerals into condition or form suitable for shipment (for example, the agglomeration of concentrates).

(4) *Definition of "concentration".* For the purpose of this paragraph, the terms "concentration" and "concentrating" mean the process of eliminating waste or of separating two or more minerals.

(5) *Definition of "loading for shipment".* The term "loading for shipment" shall not include the cost of containers, bags, or any similar items. The loading for shipment of a manufactured product is not an ordinary treatment process.